

Internal Revenue Service

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Department of the Treasury

Washington, DC 20224

Third Party Communication: None

Date of Communication: Not Applicable

Person To Contact:

, ID No.

Telephone Number:

Refer Reply To:

CC:PSI:B03

PLR-146166-10

Date:

March 28, 2011

Legend

Company =

State =

Shareholders =

a =

b =

c =

d =

e =

Dear :

We received a letter dated November 1, 2010, and subsequent correspondence, submitted on behalf of Company by its authorized representative requesting a ruling under § 1362(f) of the Internal Revenue Code (Code). This letter responds to that request.

Facts

According to the information submitted, Company is a corporation incorporated under the laws of State on a. Company elected to be an S corporation effective on a. Company made disproportionate distributions to its Shareholders from b through c to defray income taxes attributable to the income of Company. Company represents that under its governing instruments, all of Company's shares of stock have possessed identical rights to distribution and liquidation proceeds since a. Company further represents that neither Company nor its Shareholders knew that disproportionate distributions could potentially terminate Company's S corporation election.

In d, Company learned that the distributions it made from b through c were not consistent with its governing instruments and could be construed to create a second class of stock, and, thus, could potentially have terminated its S corporation election. As a result, Company made corrective distributions to its Shareholders on or before e, thus eliminating the cumulative amount of the disproportionate distributions. Company and Shareholders have consistently treated Company as an S corporation and agree to make any adjustments consistent with the treatment of Company as an S corporation as may be required by the Secretary.

Law and Analysis

Section 1361(a)(1) provides that for purposes of title 26, the term "S corporation" means, with respect to any taxable year, a small business corporation for which an election under § 1362(a) is in effect for such year.

Section 1361(b)(1) provides that for purposes of subchapter S, the term "small business corporation" means a domestic corporation which is not an ineligible corporation and which does not (A) have more than 100 shareholders, (B) have as a shareholder a person (other than an estate, a trust described in § 1361(c)(2), or an organization

described in § 1361(c)(6)) who is not an individual, (C) have a nonresident alien as a shareholder, and (D) have more than one class of stock.

Section 1.1361-1(l)(1) of the Income Tax Regulations provides, in part, that a corporation that has more than one class of stock does not qualify as a small business corporation. Except as provided in § 1.1361-1(l)(4) (relating to instruments, obligations, or arrangements treated as a second class of stock), a corporation is treated as having only one class of stock if all outstanding shares of stock of the corporation confer identical rights to distribution and liquidation proceeds. Differences in voting rights among shares of stock of a corporation are disregarded in determining whether a corporation has more than one class of stock.

Section 1.1361-1(l)(2)(i) provides, in part, that the determination of whether all outstanding shares of stock confer identical rights to distribution and liquidation proceeds is made based on the corporate charter, articles of incorporation, bylaws, applicable state law, and binding agreements relating to distribution and liquidation proceeds (collectively, the governing provisions). Although a corporation is not treated as having more than one class of stock so long as the governing provisions provide for identical distribution and liquidation rights, any distributions (including actual, constructive, or deemed distributions) that differ in timing or amount are to be given appropriate tax effect in accordance with the facts and circumstances.

Section 1362(a) provides that, except as provided in § 1362(g), a small business corporation may elect, in accordance with the provisions of § 1362, to be an S corporation.

Section 1362(d)(2)(A) provides that an election under § 1362(a) shall be terminated whenever (at any time on or after the first day of the first taxable year for which the corporation is an S corporation) such corporation ceases to be a small business corporation.

Section 1362(f) provides, in relevant part, that if (1) an election under § 1362(a) by any corporation was terminated under § 1362(d)(2) or (3); (2) the Secretary determines that the circumstances resulting in such termination were inadvertent; (3) no later than a reasonable period of time after discovery of the circumstances resulting in such termination, steps were taken so that the corporation for which the termination occurred is a small business corporation; and (4) the corporation for which the termination occurred, and each person who was a shareholder of the corporation at any time during the period specified pursuant to § 1362(f), agrees to make the adjustments (consistent with the treatment of the corporation as an S corporation) as may be required by the Secretary with respect to this period, then, notwithstanding the circumstances resulting in the termination, the corporation shall be treated as an S corporation during the period specified by the Secretary.

Conclusion

Based solely on the representations made and the information submitted, we conclude that if Company had more than one class of stock due to the disproportionate distributions, Company's S corporation election terminated on b. However, we conclude that if Company's S corporation election was terminated, such termination was inadvertent within the meaning of § 1362(f). In addition, we conclude that the corrective distributions made to Shareholders does not create a second class of stock under § 1361. Therefore, Company will be treated as continuing to be an S corporation from b and thereafter, provided Company's S corporation election was valid and was not otherwise terminated under § 1362(d).

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings, it is subject to verification on examination.

Except as expressly provided herein, we express or imply no opinion concerning the tax consequences of any aspect of any transaction or item discussed or referenced in this letter. Specifically, we express or imply no opinion regarding whether Company is otherwise eligible to be treated as an S corporation.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

Sincerely,

Mary Beth Carchia
Senior Technician Reviewer, Branch 3
Office of Associate Chief Counsel
(Passthroughs & Special Industries)

Enclosures (2)

Copy of this letter

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